

A Visual Guide to

# Navigating Down Markets

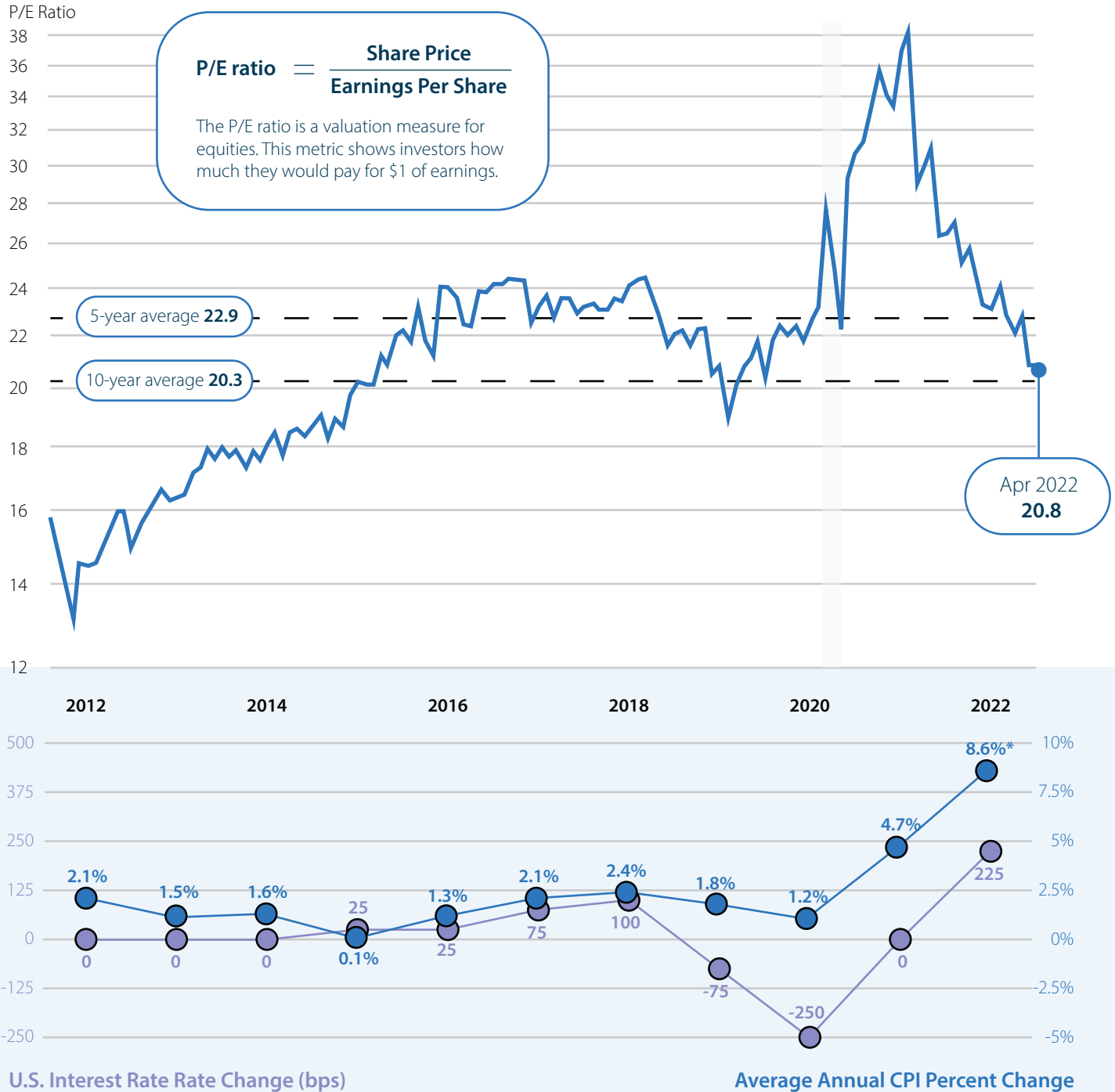


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Today, markets are facing headwinds due to the impact of capital misallocation to overpriced securities over the last decade.

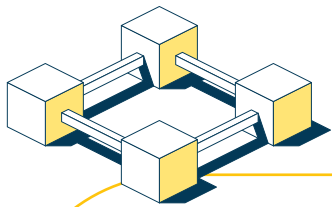
High inflation and rising interest rates have highlighted this misallocation.

S&P 500 Index Price-Earnings (P/E) Ratio 2012-2022



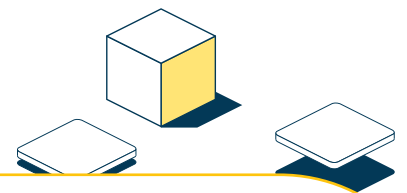
Source: Macrotrends, 08/19/22. Trailing 12-month P/E ratio between May 2012 and April 2022.  
 Forbes, 08/03/22. Minneapolis Fed, 08/22  
 \*Data as of Q1 2022

Amid market uncertainty, the following guide will provide investors with some insights to prepare for down markets.



1

# Focus on Fundamentals



When interest rates are rising and inflation is high, fundamentals relating to cash flow become more important:



Earnings Growth



Dividends



Return on Invested Capital (ROIC)

ROIC is a profitability measure. This metric shows how much a company earns on its invested capital, such as debt and equity.

**In fact, historically, improving fundamentals have been a leading indicator of sector performance over the intermediate-term.**

Source: Haver Analytics, 06/30/22

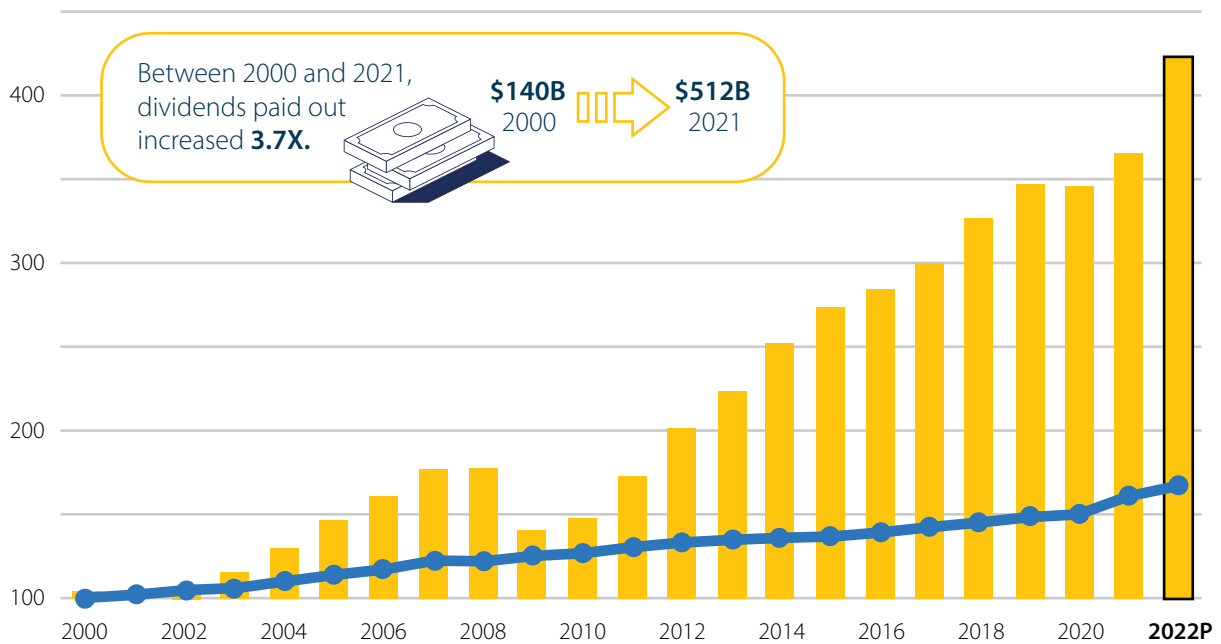


Consider how S&P 500 Index dividends have performed against inflation over the last two decades:

## S&P 500 Dividend Growth Outpaces Inflation

■ S&P 500 Dividend Annual Totals (LHS)

— U.S. CPI Urban Consumers (RHS)

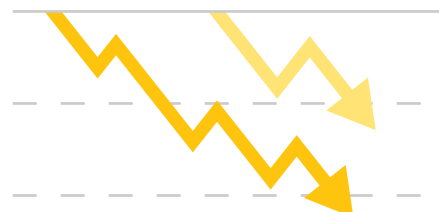


Source: S&P Dow Jones Indices LLC, Bureau of Labor Statistics, 05/23/22. Past performance is not indicative of future results. You cannot invest directly in an index. Index definitions can be found at the end of this piece.

## Not only that, dividends have historically been far less volatile than stocks.

Since 1957, stock prices were more than **2X as volatile** as their dividend cash flows.

Source: Robert Shiller, 12/31/2021.



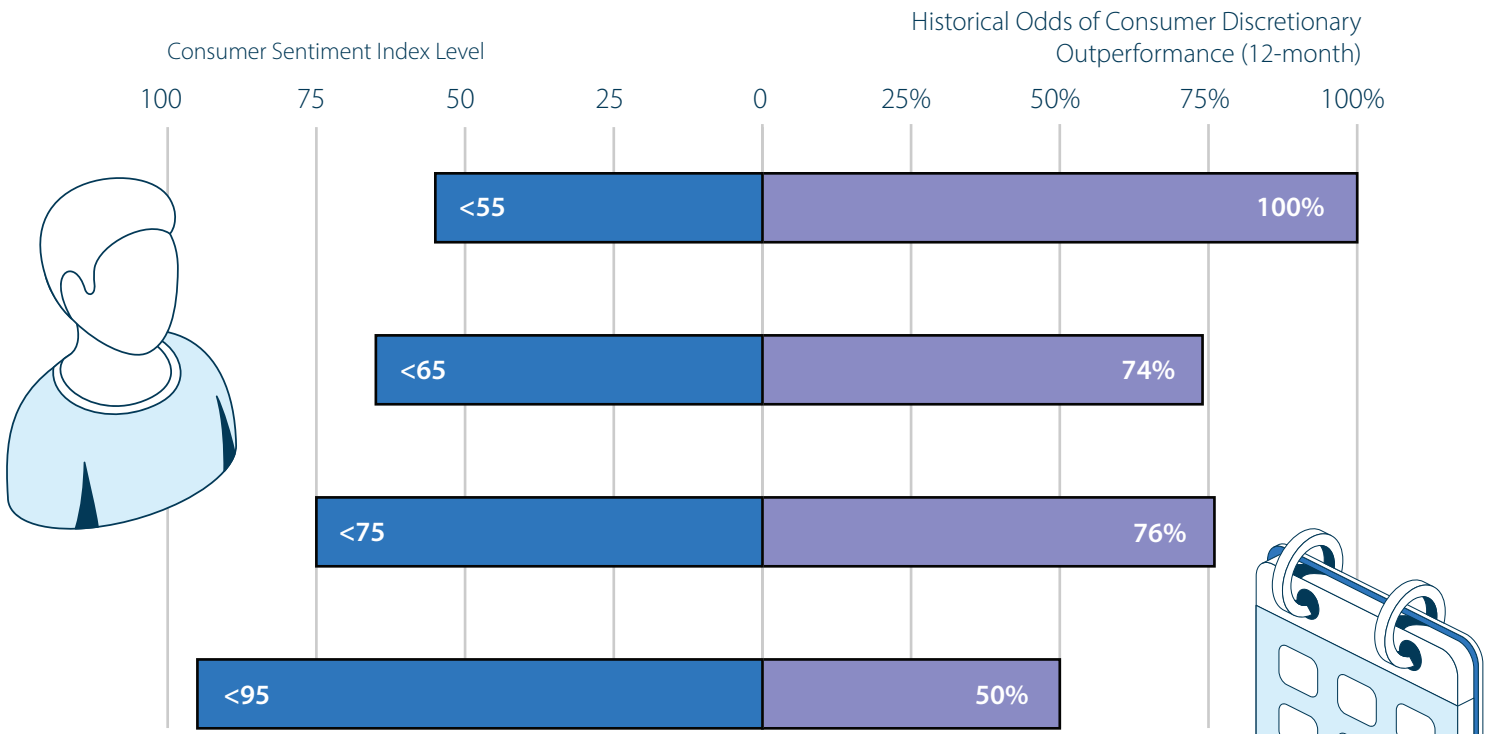
# 2

## Trouble Can Become Opportunity

Consumer sentiment is hovering near historical lows.

The good news: this may be a silver lining for the consumer discretionary sector, which has historically outperformed when sentiment sinks to this level.

### Historical Consumer Sentiment



Source: University of Michigan, Haver Analytics, FactSet, Fidelity Investments, 05/31/22. Based on top 3,000 U.S. stocks by market capitalization since 1962. Past performance is not indicative of future results.

Consumer discretionary stocks cover non-essential items such as restaurants, hotels, and automobiles.

**Given historical patterns, the consumer discretionary sector may be poised to accelerate over the next 12 months.**

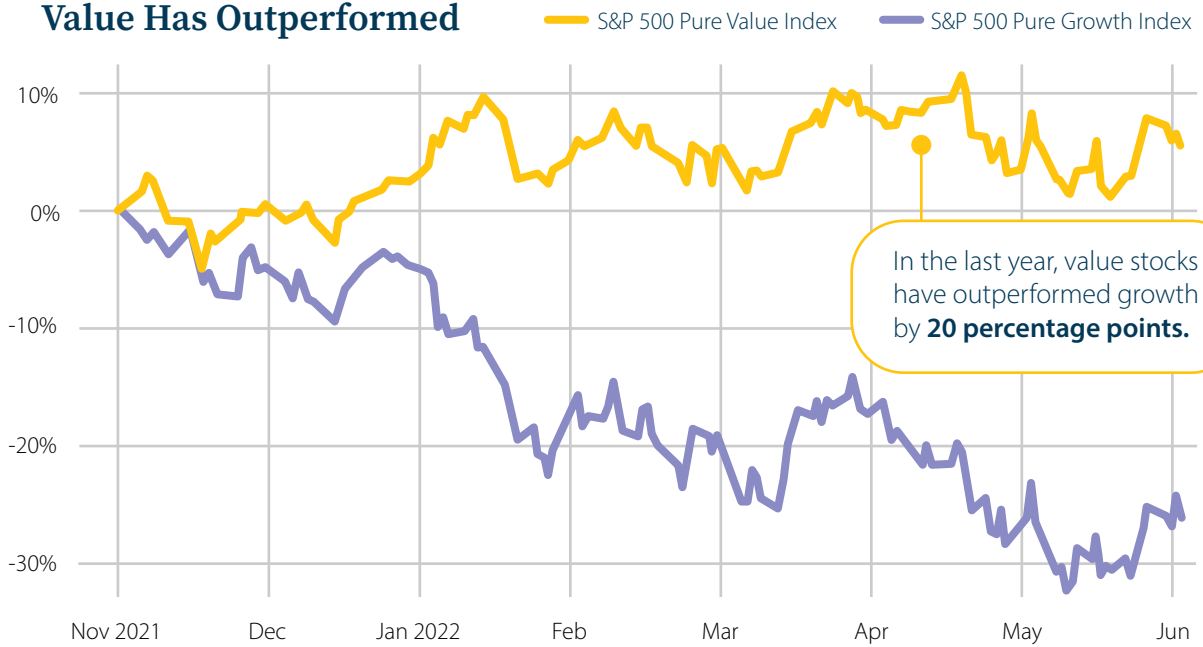


# 3 Value in Favor



Given high inflation and interest rates on the rise, it may present an opportunity for a value investment approach. **Value stocks are considered underpriced compared to the broader market and are often inflation-sensitive.**

## Value Has Outperformed

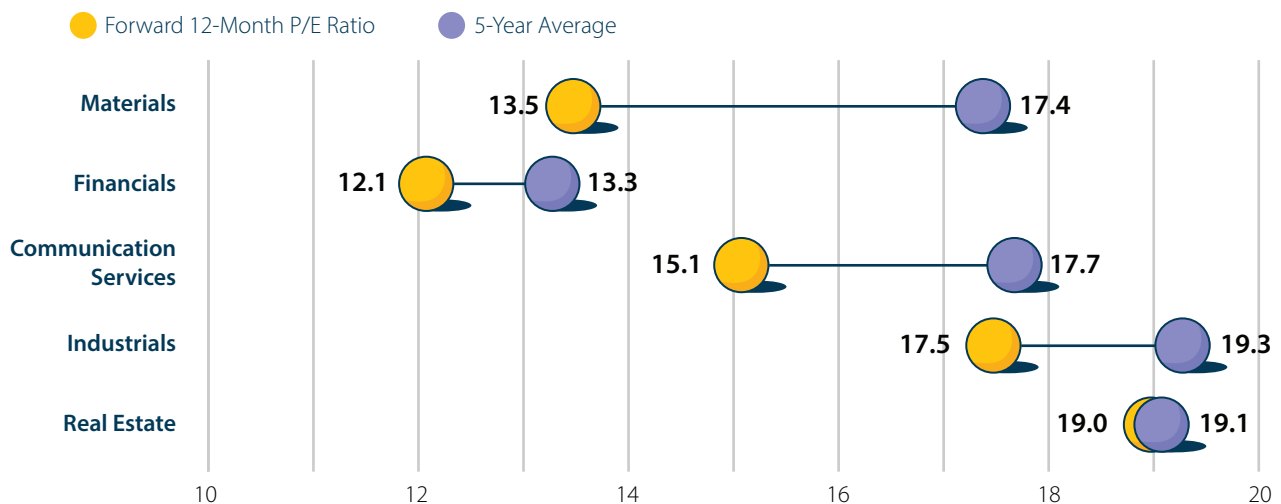


In the last year, value stocks have outperformed growth by **20 percentage points.**

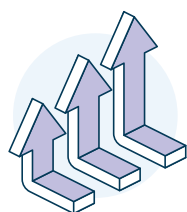
Source: S&P Global, 08/22/22. Past performance is not indicative of future results. You cannot invest directly in an index. Index definitions can be found at the end of this piece.

On a sector-level, materials, financials, and communication services are valued below their average P/E ratio, along with the following sectors:

## S&P 500 Index Sectors



Source: FactSet, 08/05/22. Past performance is not indicative of future results. You cannot invest directly in an index. Index definitions can be found at the end of this piece.



Although the tech sector has seen declines in 2022, the sector's P/E ratio (22.5) is above its 5-year average (21.7) **with 9.8% earnings growth year to date.**

Source: Factset, 08/05/22. Past performance is not indicative of future results.

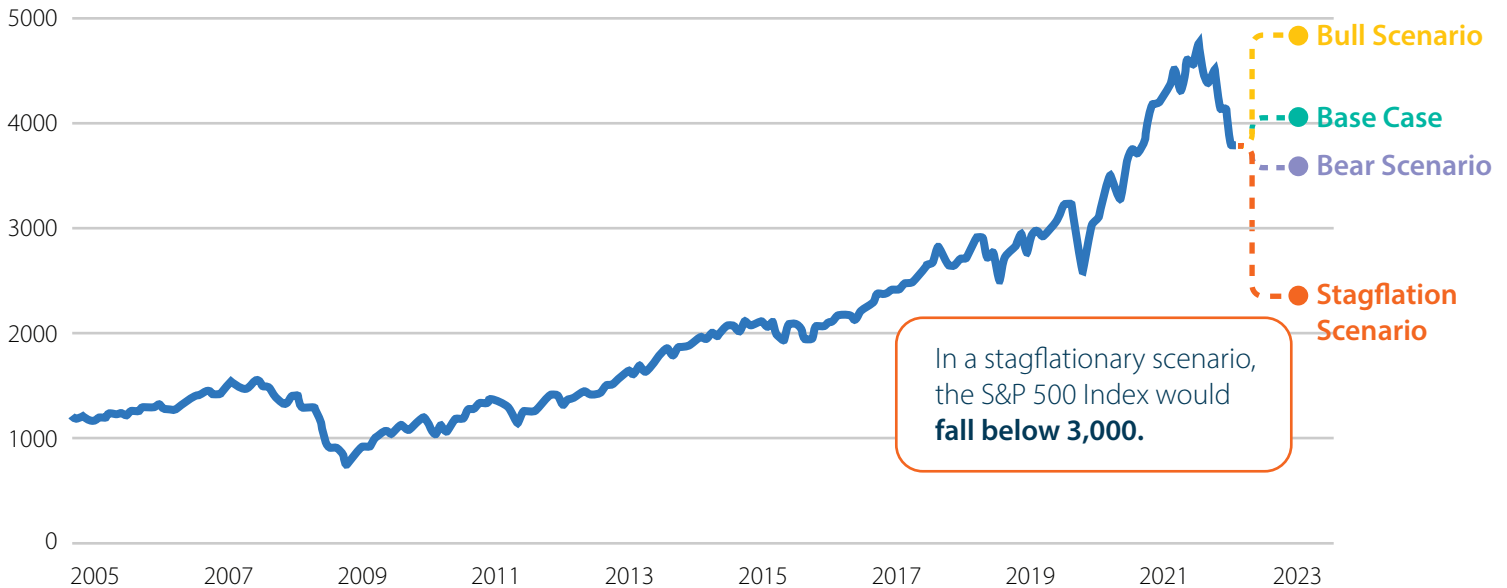
# Market Scenarios

With the S&P 500 Index finishing off its worst first half since 1970, let's look at the different scenarios going forward into 2023:



## Bull Case, Base Case, and Worst Case Scenarios

S&P 500 Index

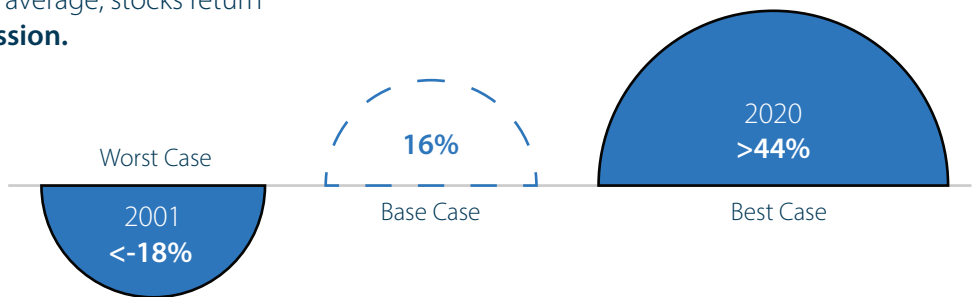


Source: Bloomberg Intelligence, 07/13/22. Past performance is not indicative of future results. This is for illustrative purposes only and not indicative of any investment. You cannot invest directly in an index. Index definitions can be found at the end of this piece.

Separately, historical data shows that on average, stocks return **16% one year after the start of a recession.**

## S&P 500 Cumulative Price Returns During Recessions

Source: YCharts, National Bureau of Economic Research, 04/01/22. Past performance is not indicative of future results.



## Which key factors will likely influence market developments?



**Inflation**



**Consumer Spending**



**Unemployment Levels**



**Interest Rates**



**Corporate Earnings Growth**

The good news is the S&P 500 Index has **recovered 7%** from its June lows as of early September. A similar trend is seen in the NASDAQ Composite Index—an index significantly weighted in tech stocks—which has **recovered 8%** over roughly the same time frame.

Source: S&P Global, Nasdaq, 09/06/22. Past performance is not indicative of future results.

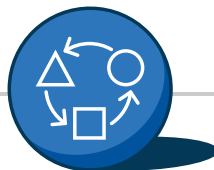
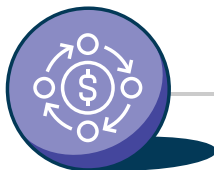


# Keeping a Clear Focus

As investors navigate down markets, rebalancing to suit their risk profile can be an important part of the process.

It's also important to remember that **markets are cyclical**.

For this reason, **staying invested, diversified, and disciplined** are critical for keeping long-term strategic goals in mind.



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The S&P 500 Index is widely regarded as the standard for measuring U.S. large-cap stock-market performance.

**S&P 500 Index Dividend Annual Totals** represent estimated dividend payments of the S&P 500 Index.

**The CPI Urban Consumers Index** measures the average levels of prices in the U.S. based on a basket of goods and services over a given time period paid by urban consumers.

**The Consumer Sentiment Index** by the University of Michigan measures consumer confidence based on consumer surveys on market conditions, personal finances, and business conditions.

**The S&P 500 Pure Growth Index** measures the performance of stocks with the strongest growth characteristics.

**The S&P 500 Pure Value Index** measures the performance of stocks with the strongest value characteristics.

**The NASDAQ Composite Index** includes over 3,700 stocks listed on the Nasdaq stock exchange. Over half of the index comprises of stocks in the technology sector.

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